



September 23, 2004

## Highlights of the Conference Report to Accompany H.R. 1308, Working Families Tax Relief Act of 2004

*The Conference Report to H.R. 1308, H. Rept. 108-696, was filed on September 23, 2004.*

### NOTEWORTHY

- The Conference Report extends three expiring provisions of the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA)<sup>1</sup> – the \$1,000 child tax credit, the expanded 10-percent tax bracket, and the marriage-penalty relief. As a result, these provisions will continue without reduction until they expire in 2011.
- The Conference Report accelerates the refundability of the child tax credit adopted under JGTRRA. Accordingly, for 2004 through 2010, the child credit will be refundable to the extent of 15 percent of the taxpayer's earned income in excess of \$10,750 (indexed for inflation). The Conference Report also permits members of the military to include combat pay as earned income for purposes of calculating the child tax credit and the earned-income tax credit. Additionally, the Conference Report adopts a uniform definition of a "child" for purposes of the tax code.
- The Conference Report extends through 2005 the current exemption amount of \$58,000 for joint filers (\$40,250 for single taxpayers) that individuals may claim under the Alternative Minimum Tax (AMT).
- The Conference Report also extends through December 31, 2005 various provisions of the tax code that have expired or will soon expire.

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<sup>1</sup>H.R. 2, 108th Congress, 1st Session, Public Law 108-27, May 28, 2003.

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## Background

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The House of Representatives passed H.R. 1308 by voice vote on March 19, 2003. The Senate considered the bill on June 5, 2003, passing it with a substitute amendment. On June 12, 2003, the House agreed to the Senate version with a new House amendment. A conference committee was convened on September 21, 2004, and the Conference Report, House Report 108-696, was filed on September 23, 2004.

The majority of the House-passed version of H.R. 1308 relates to modifications to the tax code with respect to certain benefits received by members of the military. These provisions were enacted on November 11, 2003, as part of the Military Family Tax Relief Act of 2003.<sup>2</sup>

The balance of H.R. 1308 as passed by the House relates to expansion of the child tax credit, including the acceleration of the phase-in of the credit, which was enacted as part of JGTRRA. As a result, the amount of the child tax credit was raised to \$1,000 beginning in 2003 through 2004. However, under current law, it will revert to \$700 in 2005 and will not reach \$1,000 again until 2010.

JGTRRA also provided four other temporary provisions, which – under current law – are set to expire at the end of 2004:

- The upper limit of the 10-percent tax bracket was expanded from \$12,000 to \$14,000 for joint filers (\$6,000 to \$7,000 for single taxpayers).<sup>3</sup> In 2005, under current law, the upper limit will revert to \$12,000 for joint filers and \$6,000 for single taxpayers. Thereafter, it will gradually increase but will not reach the current levels again until 2008.
- The marriage penalty in the 15-percent tax bracket was eliminated by increasing the upper limit of that bracket from \$47,450 to \$56,800 (double the \$28,400 upper limit of the 15-percent bracket for single individuals).<sup>4</sup> In 2005, under current law, the upper limit for joint filers will drop to approximately \$52,290 (180 percent of the single-filer bracket, as adjusted for inflation). Thereafter, the 15-percent bracket will gradually expand for joint filers but will not reach the current level again until 2008.
- The marriage penalty in the standard deduction was also eliminated by increasing the amount of the standard deduction for joint filers from \$7,950 to \$9,500 (double the

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<sup>2</sup>H.R. 3365, 108th Congress, 1st Session, Public Law 108-121, November 11, 2003.

<sup>3</sup>For 2004, the upper limit of the bracket is \$14,300 for joint filers and \$7,150 for single individuals due to inflation adjustments.







































<sup>4</sup>For 2004, the upper limit on the 15-percent tax bracket is \$58,100 for joint filers (\$29,050 for single taxpayers) due to inflation adjustments.

\$4,750 standard deduction for single individuals).<sup>5</sup> In 2005, under current law, the standard deduction for joint filers will drop to approximately \$8,439 (174 percent of a single-filer deduction, as adjusted for inflation), restoring the marriage penalty. Thereafter, the standard deduction for joint filers will gradually increase, but the marriage penalty will not be eliminated again until 2009.

- The exemption from the individual AMT was increased from \$49,000 to \$58,000 for joint filers (from \$35,750 to \$40,250 for single taxpayers).<sup>6</sup> In 2005, under current law, the exemption amounts will fall to \$45,000 for joint filers and \$33,750 for single taxpayers, which were the exemption amounts prior to the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).<sup>7</sup> Under current law, the exemption amounts are not scheduled to increase.

The fact that, under current law, the majority of these provisions decline next year and then gradually increase, reaching current levels at some point in the next few years, creates something of a “trench” in the levels of these provisions – the Conference Report generally fills in this trench leaving the provisions at their current levels through 2010 (except for the AMT exemption, which is extended for only one year). The following chart reflects this phenomenon under current law:

**Current Law with Respect to  
Certain Family Tax Provisions**

Provision	2004	2005	2006	2007	2008	2009	2010
<b>Child Tax Credit</b>							
<b>10-percent Tax Bracket</b>							
<b>Marriage Penalty – 15-percent Tax Bracket</b>							
<b>Marriage Penalty – Standard Deduction</b>							
<b>AMT Exemption</b>							
 Fully phased-in  Gradual increase  Pre-2001 level; no increase							

Both the Senate and House versions of H.R. 1308 also included provisions to increase the earned-income threshold with respect to the refundability of the child tax credit, and both bills included provisions to eliminate the marriage penalty under the child tax credit. In addition, the

<sup>5</sup>For 2004, the standard deduction is \$9,700 for joint filers (\$4,850 for single taxpayers) due to inflation adjustments.

<sup>6</sup>The exemption amounts are not indexed for inflation; accordingly, the same levels apply to 2003 and 2004.

<sup>7</sup>H.R. 1836, 107th Congress, 1st Session, Public Law 107-16, June 7, 2001.

Senate bill included a uniform definition of a “child” for purposes of the tax code’s dependency exemption, child tax credit, earned-income credit, dependent-care credit, and head of household filing status.

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## Conference Report Provisions

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### **Title I – Extension of Family Tax Provisions**

#### **Child Tax Credit Extension**

The Conference Report extends the current \$1,000 child tax credit. Accordingly, it will remain at its current level through taxable year 2010. Pursuant to the sunset provisions of EGTRRA, the child tax credit will revert to \$500 for taxable years 2011 and thereafter.

#### **Expansion of the 10-percent Tax Bracket**

The Conference Report adds a new provision that extends the expansion of the 10-percent tax bracket. Accordingly, for 2005 through 2010, the upper limit of the 10-percent tax bracket will remain \$14,000 for joint filers and \$7,000 for single taxpayers, both levels indexed for inflation. Pursuant to the sunset provisions of EGTRRA, the 10-percent tax bracket will be eliminated entirely beginning in taxable year 2011 and thereafter.

#### **Marriage Penalty Relief Extension**

The Conference Report adds two new provisions concerning the elimination of the marriage penalty. The first extends current law with respect to the upper limit on the 15-percent tax bracket. Accordingly, the upper limit with respect to joint filers will continue to be equal to twice the upper limit of the 15-percent tax bracket for single taxpayers, thereby eliminating the marriage penalty in the 15-percent tax bracket for 2005 through 2010.

The second marriage-penalty provision of the Conference Report relates to the elimination of the marriage penalty in the standard deduction. Under this provision, the standard deduction for joint filers will continue to be twice the standard deduction for single taxpayers in 2005 through 2010.

Pursuant to the sunset provisions of EGTRRA, the marriage penalty in the 15-percent tax bracket and in the standard deduction will revert to their pre-2001 levels beginning in taxable years 2011 and thereafter.

#### **Enhanced Refundability of Child Tax Credit**

The Conference Report includes a provision from the Senate- and House-passed versions of H.R. 1308, which accelerates the increase in refundability of the child tax credit. Under current law, for 2004 the child credit is refundable to the extent of 10 percent of the taxpayer’s

earned income in excess of \$10,750 (indexed for inflation). The earned income limitation under current law is scheduled to increase to 15 percent in taxable years 2005 through 2010. The Conference Report applies the 15-percent threshold to taxable years retroactively to 2004 and continues that level through 2010.

### **Inclusion of Combat Pay as Earned Income**

The Conference Report includes a provision from the Senate-passed bill that permits members of the military to include combat pay as earned income for purposes of calculating the child tax credit. Under the Conference Report, members of the military may also elect in 2004 and 2005 to include combat pay for purposes of the earned-income tax credit. Under current law, combat pay is not subject to income tax and, therefore, is excluded from earned income for purposes of these tax credits.

### **Alternative Minimum Tax**

The Conference Report adds a new provision, which extends through 2005 the individual AMT exemption amount under current law of \$58,000 for joint filers (\$40,250 for single taxpayers). Beginning in 2006, the exemption amounts will fall to their pre-2001 levels of \$45,000 for joint filers and \$33,750 for single taxpayers.

As noted below in Title III, the Conference Report also extends the provision of the tax code that allows taxpayers to deduct nonrefundable personal credits when calculating the individual AMT. This provision expired on December 31, 2003.

## **Title II – Uniform Definition of a Child**

The Conference Report adopts the uniform definition of a child contained in the Senate-passed version of H.R. 1308. Current law contains five commonly used provisions that provide benefits to taxpayers with children: (1) the dependency exemption; (2) the child credit; (3) the earned-income credit; (4) the dependent-care credit; and (5) head-of-household filing status. Each provision has separate criteria for determining whether the taxpayer qualifies for the applicable tax benefit with respect to a particular child. The separate criteria include factors such as the relationship (if any) the child has to the taxpayer, the age of the child, and whether the child must live with the taxpayer. Thus, a taxpayer is required to apply different definitions to the same individual when determining eligibility for these provisions, and a child who qualifies a taxpayer for one provision does not automatically qualify the taxpayer for another provision.

Under the uniform definition, in general, a child is a qualifying child of a taxpayer if the child satisfies each of four tests:

- (1) The child has a specified relationship to the taxpayer – e.g., the taxpayer's son, daughter, stepson, stepdaughter, brother, sister, stepbrother, stepsister, or a

descendant of any such individual (including legally adopted individuals and foster children);

- (2) The child has the same principal place of abode as the taxpayer for more than one-half of the taxable year;
- (3) The child has not yet attained a specified age. In general, a child must be under age 19 (or under age 24 in the case of a full-time student) in order to be a qualifying child. No age limit applies with respect to individuals who are totally and permanently disabled at any time during the calendar year. The Conference Report retains the requirements under current law that a child must be under age 13 (if he or she is not disabled) for purposes of the dependent-care credit, and under age 17 (whether or not disabled) for purposes of the child credit; and
- (4) The child has not provided more than one-half of his or her own support for the particular calendar year.

The Conference Report also includes the tie-breaking rule from the Senate-passed version of H.R. 1308, which applies if more than one taxpayer claims a child as a qualifying child.

Under the Conference Report's uniform definition of a child, a taxpayer generally may still claim an individual who does not meet the new uniform definition as a dependent if the dependency requirements under current law are satisfied. The Conference Report generally does not modify the particular provisions of each tax benefit or the rules for determining whether individuals other than children qualify for each tax benefit.

### **Title III – Expiring Provisions**

The Conference Report adds a new title to the legislation relating to provisions of the tax code that have expired or will soon expire. Title III is drawn from the legislation to replace the Foreign Sales Corporation and Extraterritorial Income tax rules (S. 1637/H.R. 4520), which the Senate and House passed earlier this year.

Specifically, the Conference Report adds a straight extension of the following expiring provisions of the tax code. Unless otherwise noted, each provision is extended through December 31, 2005.

- Research and development credit;
- Parity in the application of certain limits to mental health benefits;
- Work opportunity credit and welfare-to-work credit;
- Qualified zone academy bonds;
- Cover over of tax on distilled spirits;
- Deduction for corporate donations of scientific property and computer technology;
- Deduction for certain expenses of school teachers;
- Expensing of environmental remediation costs;

- Certain New York Liberty Zone benefits (authority to issue New York Liberty Zone Bonds is extended through December 31, 2009);
- Tax incentives for investment in the District of Columbia;
- Disclosure of tax information to facilitate combined employment-tax reporting;
- Allowance of nonrefundable personal credits against regular and minimum tax liability;
- Indian employment tax credit;
- Accelerated depreciation for business property on Indian reservation;
- Disclosure of return information relating to student loans;
- Disclosures relating to terrorist activities;
- Joint review of strategic plans and budget for the Internal Revenue Service; and
- Availability of medical savings accounts.

Additionally, the Conference Report extends through December 31, 2005 four energy-related provisions, which are subject to expiration:

- Credit for electricity produced from certain renewable resources;
- Taxable income limit on percentage depletion for oil and natural gas produced from marginal properties;
- Elimination of phaseout of credit for qualified electric vehicles for 2004 and 2005; and
- Elimination of phaseout for deduction for clean-fuel vehicle property for 2004 and 2005.

## **Title IV – Technical Corrections**

The Conference Report includes technical corrections to various tax bills enacted between 1996 and 2003.

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### **Cost**

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The Joint Committee on Taxation estimates that the bill will reduce federal tax revenues by approximately \$146 billion over ten years.